

**SPECIAL TAX ALERT:
EMERGENCY ECONOMIC STABILIZATION ACT OF 2008 INCLUDES REAL
ESTATE TAX CHANGES**

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On October 3, 2008, as a stabilizer to the troubled economy, the President signed into law H.R. 1424,¹ which includes the Emergency Economic Stabilization Act of 2008 (Division A of H.R. 1424), the Energy Improvement and Extension Act of 2008 (Division B of H.R. 1424), and the Tax Extenders and Alternative Minimum Tax Relief Act of 2008 (Division C of H.R. 1424). This legislation authorizes the Federal government to purchase and insure certain types of troubled assets, as well as provides tax incentives for energy production and conservation, extends expiring tax provisions, and provides certain individual income tax relief. Specifically related to real estate, H.R. 1424 extends an expiring tax provision allowing non-itemizers a standard deduction for real property taxes, provides additional tax relief related to federally-declared disasters, extends the exclusion on home mortgage debt relief, provides more favorable depreciation for certain assets, and extends the deduction for environmental remediation costs.

Property Tax Deduction for Non-Itemizers

The Housing Assistance Tax Act of 2008,² which was enacted on July 30, 2008, created a new standard deduction for state and local real property taxes.³ Prior to that Act, a taxpayer had to itemize deductions, rather than take a standard deduction, in order to deduct property taxes. The Housing Assistance Tax Act created a "real property tax deduction" for non-itemizers in addition to the standard deduction amount.⁴ Under this provision, taxpayers can deduct up to \$500 for single taxpayers (\$1,000 for joint returns) for real property taxes paid.⁵ However, as originally enacted, the deduction was only available for the 2008 tax year.⁶ H.R. 1424 extends the provision to include the 2009 tax year also.⁷

Losses Attributable to Federally Declared Disasters

H.R. 1424 makes several tax changes to benefit taxpayers victimized by disasters.

¹ H.R. 1424, P.L. 110-374.

² H.R. 3221, P.L. 110-289

³ H.R. 3221, Sec. 3012, amending I.R.C. § 63.

⁴ For 2008, the standard deduction amount is \$5,450 for unmarried taxpayers and \$10,900 for joint returns. Rev. Proc. 2007-66, 2007-45 I.R.B. 970

⁵ I.R.C. § 63(c)(7). For taxpayers itemizing their deduction, the full amount of property taxes will still be deductible as an itemized deduction. I.R.C. § 164(a)(1).

⁶ I.R.C. § 63(c)(1)(C).

⁷ H.R. 1424, Division C Section 204.

Changes to Casualty Loss Deduction:

Internal Revenue Code § 165 allows an individual to deduct personal casualty losses. However, these deductions are currently limited for personal (non-business) casualty losses in several respects. Prior to H.R. 1424, an individual could deduct a personal casualty loss only to the extent that the loss exceeds \$100 from each casualty.⁸ For taxable years beginning after December 31, 2008, H.R. 1424 raises this limit to \$500,⁹ but the limit returns to \$100 for taxable years beginning after December 31, 2009.

In addition, I.R.C. § 165 generally allows a deduction for aggregate net casualty and theft losses only to the extent that they exceed 10% of a taxpayer's adjusted gross income (AGI) for the year.¹⁰ H.R. 1424 waives the 10% of AGI limit for losses attributable to a federally-declared disaster¹¹ occurring after December 31, 2007, and before January 1, 2010.¹²

Increase in Standard Deduction by Disaster Casualty Loss:

Prior to H.R. 1424, taxpayers had to itemize deductions in order to deduct casualty losses. H.R. 1424 adds a "disaster loss deduction" as a component of the standard deduction.¹³ This disaster loss deduction is the net casualty loss attributable to a federally declared disaster occurring before January 1, 2010. This provision will benefit taxpayers with a disaster loss whose other itemized deductions are less than their standard deduction.

Expensing of Qualified Disaster Expenses:

H.R. 1424 adds new I.R.C. § 198A, which provides for expensing of certain qualified disaster expenses. Under this new Code section, a taxpayer may elect to treat any "qualified disaster expense" as a deductible expense for the year in which it is paid or incurred. The expenses covered by this provision include expenses incurred in connection with a trade or business or business-related property for the repair of such property, or the removal of debris from, or demolition of structures on, real property damaged or destroyed as a result of a federally declared disaster.¹⁴ This provision allows a current deduction for expenses that might otherwise have to be capitalized.¹⁵ This provision applies to federally declared disasters occurring after December 31, 2007 and before January 1, 2010.

⁸ I.R.C. § 165(h)(1).

⁹ H.R. 1424, Division C Section 706(c).

¹⁰ I.R.C. § 165(h)(2).

¹¹ A "federally declared disaster" is any disaster subsequently determined by the President to warrant assistance by the Federal government under the Robert T. Stafford Disaster Relief and Emergency Assistance Act. *See* H.R. 1424, Division C Section 706(a), substituting "federally declared disaster" for "Presidentially declared disaster" several places in the Code.

¹² H.R. 1424, Division C Section 706(a), adding I.R.C. § 165(h)(3). For purposes of applying the 10% of AGI limit to other personal casualty losses, losses deductible under this provision are disregarded. Thus the provision has the effect of treating disaster losses attributable to federally declared disasters as a deduction separate from all other casualty and theft losses.

¹³ H.R. 1424, Division C Section 706(b), adding I.R.C. § 63(c)(1)(D), for disasters declared in taxable years beginning after December 31, 2007.

¹⁴ H.R. 1424, Division C Section 707, adding I.R.C. § 198A.

¹⁵ *See* I.R.C. § 263 and Prop. Reg. § 1.263(a)-3(f)(3)(iv).

Net Operating Losses Attributable to Federally Declared Disasters:

H.R. 1424 provides a special five-year carryback period for net operating losses to the extent the NOL is created by a federally declared disaster.¹⁶ The normal carryback period is two years, or three years for certain casualty losses.¹⁷ This provision applies to losses arising in tax years beginning after December 31, 2007 in connection with disasters declared after that date, and only with respect to disasters occurring before January 1, 2010.¹⁸

Temporary Relief Provisions for Midwestern Disaster Area and Hurricane Ike:

H.R. 1424 includes a number of temporary tax relief provisions for victims of severe storms, tornados, and flooding in the states of Arkansas, Illinois, Indiana, Iowa, Kansas, Michigan, Minnesota, Missouri, Nebraska, and Wisconsin. These provisions apply to federally declared disasters between May 20 and August 1, 2008.¹⁹ In addition, temporary tax-exempt bond financing and low-income housing tax relief was provided for areas damaged by Hurricane Ike.²⁰

Extension of Gain Exclusion Resulting from Debt Discharge on Home Mortgages

The Mortgage Forgiveness Debt Relief Act of 2007, which was enacted on December 20, 2007²¹ gave relief to taxpayers in foreclosure by amending I.R.C. §108 to exclude from a taxpayer's gross income any discharge of debt on a qualified principal residence. Many taxpayers facing a foreclosure of their home may have debt relief in the amount of the difference between the adjusted issue price of the debt being cancelled and the amount used to satisfy the debt (typically the value of the property), which amount is income under I.R.C. § 108 unless certain exceptions apply.²² Homeowners may also have relief of indebtedness income from a modification of their current loan, including changes to a loan's adjustable interest rate provisions.²³

The Mortgage Forgiveness Debt Relief Act of 2007 excluded from the gross income of a taxpayer any discharge of indebtedness income by reason of a discharge, in whole or in part, of "qualified principal residence indebtedness."²⁴ Qualified principal residence

¹⁶ H.R. 1424, Division C Section 708, amending I.R.C. § 172.

¹⁷ I.R.C. § 172(b)(1)(A)(i) and § 172(b)(1)(F).

¹⁸ I.R.C. § 172(j)(1)(A)(i)(I).

¹⁹ See H.R. 1424 Division C Section 702.

²⁰ See H.R. 1424 Division C Section 704.

²¹ P.L. 110-142, § 2

²² I.R.C. §§ 108(a)(1)(A) – (D).

²³ See Treas. Reg. § 1.1001-3.

²⁴ I.R.C. § 108(h)(2).

indebtedness means up to \$2 million of acquisition indebtedness²⁵ with respect to a taxpayer's principal residence.²⁶

As originally enacted, this relief from discharge of indebtedness income on qualified principal residence debt was available only for three years, on debt discharged beginning January 1, 2007 and ending on December 31, 2009.²⁷ H.R. 1424 has extended this provision for three additional years, for discharges of debt on or after January 1, 2010 and before January 1, 2013.²⁸

Fifteen Year Straight Line Depreciation Extended for Certain Real Estate Improvements

Generally the cost of non-residential real property must be depreciated over a 39-year recovery period.²⁹ However, certain qualified leasehold improvements and qualified restaurant improvements can be depreciated over a 15-year recovery period.³⁰ That 15-year recovery treatment was available for qualified leasehold or restaurant improvements that were placed in service prior to January 1, 2008. H.R. 1424 has extended this provision to qualified leasehold or restaurant improvements placed in service prior to January 1, 2010.³¹ In addition, the definition of qualified restaurant property for this purpose is expanded to include new construction.³² Prior to this change, qualified restaurant property included improvements to a building but not the building itself.

H.R. 1424 adds another category of 15-year property, and provides that qualified retail improvements that are placed in service after December 31, 2008 and prior to January 1, 2010 can be depreciated over 15 years.³³ Qualified retail improvement property for this purpose is defined as any improvement to an interior portion of a non-residential building if the portion is open to the general public and used in the retail trade or business of selling tangible personal property to the general public, and the improvement is placed in service more than three years after the building was placed in service. The covered improvements do not include expenditures attributable to the enlargement of the building,

²⁵ Acquisition indebtedness is defined in I.R.C. § 163(h)(3)(B) as any indebtedness incurred in acquiring, constructing, or substantially improving any qualified residence of the taxpayer, for purposes of the home mortgage interest deduction of I.R.C. § 163(h), provided the debt is secured by the residence. Acquisition indebtedness will also include debt resulting from the refinancing of the original acquisition indebtedness, up to the amount of the refinanced debt, but not necessarily home equity loans.

²⁶ Principal residence has the same meaning for this purpose as under I.R.C. § 121. I.R.C. § 108(h)(5). Note that the taxpayer can have only one principal residence. Thus, this exclusion will not apply to vacation or second homes, even though the taxpayer may be able to deduct the mortgage interest on the second home under I.R.C. § 163(h).

²⁷ I.R.C. § 108(a)(1)(E).

²⁸ H.R. 1424, Division A Section 303, amending I.R.C. § 108(a)(1)(E).

²⁹ I.R.C. § 168(c).

³⁰ I.R.C. § 168(e)(3)(E)(iv) and (v).

³¹ H.R. 1424, Division C Section 305(a), amending I.R.C. § 168(e)(3)(E)(iv) and (v).

³² H.R. 1424, Division C Section 305(b), amending I.R.C. § 168(e)(7).

³³ H.R. 1424, Division C Section 305(c), adding I.R.C. § 168(e)(3)(E)(ix) and § 168(e)(8).

any elevator or escalator, any structural component benefiting a common area, or the internal structural framework of the building.³⁴

In addition, H.R. 1424 allows machinery or equipment used in a farming business to be depreciated over a 5-year period, where the original use of the property begins with the taxpayer after December 31, 2008, and the property is placed in service before January 1, 2010. Certain types of property are excluded from this category.³⁵

Deduction of Environmental Clean-Up Costs

Under I.R.C. § 198, a taxpayer may elect to currently deduct certain environmental clean-up costs – the expenses of remedying environmental contamination – that would otherwise have to be capitalized. However, this election expired for expenses paid or incurred after December 31, 2007. H.R. 1424 extends this provision for expenses paid or incurred on or before December 31, 2009.³⁶

Miscellaneous Provisions

H.R. 1424 also includes the following extenders:

- The deduction for energy efficient commercial buildings provided in I.R.C. § 179D(h) has been extended for five years, through December 31, 2013.³⁷
- The 30% credit for solar property, fuel cell property, and microturbine property has been extended for eight years, through December 31, 2016, and the category “combined heat and power system property” has been added to the list of property eligible for the energy credit.³⁸
- The increased rehabilitation credit allowed by I.R.C. § 1400N(h) for structures in the Gulf Opportunity Zone is extended for one year to December 31, 2009.³⁹

³⁴ I.R.C. § 168(3)(8)(C).

³⁵ H.R. 1424, Division C Section 505, amending I.R.C. § 168(e)(3)(B).

³⁶ H.R. 1424, Division C Section 318, amending I.R.C. § 198(h).

³⁷ H.R. 1424, Division B Section 303.

³⁸ H.R. 1424, Division B Section 103, amending I.R.C. § 48.

³⁹ H.R. 1424, Division C, Section 320.